

# Economics Lecture 4 - Exercise

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## Exercise 1

Explain what the uncompensated demand is.

Suppose we have two goods. Price of good 1 is 10 and price for good 2 is 15. Utility indifference curve is set at level 6. Construct a diagram with quantities on the axis and draw the indifference curve.

Can you draw the budget line which minimize the cost?

## Exercise 2

Explain the concept of income effect and substitute effect.

Assume you have two goods and an initial optimal point.

What happen if the price of good 1 is cut by half?

Can you represent how is the income effect and the substitute effect?

## Exercise 3

Assume you deal with the following utility function  $u(x,y) = 4xy^2$ .

The price for good  $x$  is  $p_x$  and for good  $y$  is  $p_y$ .

Can you find compensated demand?

Can you find income effect and substitution effect?